IN THE HIGH COURT OF UTTARANCHAL AT NAINITAL

INCOME TAX APPEAL NO. 02 OF 2003

AND

INCOME TAX APPEAL NO. 01 OF 2003

Date of decision: 24 October 2003

For the approval of:

Hon'ble Chief Justice S.H. Kapadia.

Hon'ble Mr. Justice M.M. Ghildiyal.

- Whether the order/judgment should be sent to the reporters for reporting? (Yes)

- Whether the reporters be allowed to see the judgment? ( )

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IN THE HIGH COURT OF UTTARANCHAL AT NAINITAL

INCOME TAX APPEAL NO. 02 of 2003

Shri Manik Chandra
53, Gandhi Road, Dehradun ---- Appellant

Vs.

The Assistant Commissioner of Income-tax,
Investigation Circle, Dehradun ---- Respondent

AND

NCOME TAX APPEAL NO. 01 of 2003

Shri Kapoor Chand
53, Gandhi Road, Dehradun ---- Appellant

Vs.

The Assistant Commissioner of Income-tax,
Investigation Circle, Dehradun ---- Respondent

Mr. Arvind Vashishth, Counsel for the appellant.
Mr. P. Maulekhi, Counsel for the Department.

Coram: Hon'ble S.H. Kapadia, C.J.,
Hon'ble M.M. Ghildiyal, J.

Date: 24th October, 2003;

ORAL JUDGMENT (Hon'ble S.H. Kapadia, C.J.)

1. The above two appeals raise common question of law and, therefore, both the appeals are heard together and disposed of by this common judgment. Both the appeals are filed by the assessee. They pertain to assessment year 1980-81. For the sake of convenience, we are mentioning hereinbelow the facts in Income Tax Appeal No. 02 of 2003.

2. FACTS

Appellant Manik Chandra is an individual. For assessment year 1980-81 he was assessed u/s 143(3) of the Income Tax Act. The order of assessment was passed on 28th February 1981. Thereafter on 31st January 1985 he was served with a notice u/s 148 of the Act. He filed his return of income on 26th February 1985. He objected to the re-opening of assessment. The assessment was re-opened for following reasons:

Nidhi Life Trust was created by one Shri Surender Goyal, brother-in-law of the assessee, by settling Rs. 7,500/- in favour of the Trust. Similarly, Ruchi Life Trust was created by Yogender Goyal, brother-in-law of the assessee, by settling Rs. 7,500/- in favour of the Trust. The minor daughters of the assessee, Km. Nidhi and Km. Ruchi were respective beneficiaries under the aforestated Trusts. Under the aforestated Trust Deeds the income from the Trust fund were to be accumulated and held by the Trustees and was to be hand over to the two daughters of the assessee on their attaining the age of 18. Under the Trust Deeds the trust funds were invested in partnership firms, M/s Chandra Brothers and M/s Commercial Body Builders by the Trusts of Nidhi Life Trust and similarly the funds of Ruchi Life Trust were invested in the partnership firm, Kailash Traders. During the assessment year in question the two Trusts earned income from the said partnership firms amounting to Rs. 1.12 lacs which was assessed in the hands of the respective Trusts with an order dated 25th March 1983 passed u/s 143(3) of the Income Tax Act. However, the assessment was re-opened on 21st March 1988 with an order u/s 143(3)/148 of the Income Tax Act and the said income of Rs. 1.12 lacs was assessed in the hands of the assessee under Explanation 2A of section 64(1)(iii) on the ground that the said income of Rs. 1.12 lacs had to be clubbed with the income of the assessee in respect of the assessment year 1980-81. Being aggrieved by the order of re-

assessment dated 21st March 1988, the assessee went in appeal before CIT(Appeals). By order dated 5th February 1996, the learned CIT(Appeals) took the view that the minors had no right to receive the income of the Trust till the age of 18. The learned CIT(Appeals) took the view that since the minors had no right to receive the income during their minority the provisions of section 64(1)(iii) read with Explanation 2A was not applicable and therefore the income of Rs. 1.12 lacs could not be clubbed with the income of the assessee. Being aggrieved by the order passed on 5th February 1996 by CIT(Appeals), the department preferred an appeal before the Income Tax Appellate Tribunal, New Delhi. By impugned judgment and order dated 22nd July 2002 the Tribunal took the view that the two Trusts were created for the benefit of minor children. It was held that the income was generated by way of investments made by the Trust for the benefit of the minors. It was held that the right to receive the income had accrued to the minors but payment was to be made to the minors on their attaining majority. It was further held that the income which was accumulated was for benefit of the partners of the firm in which investment was made by the Trustees and therefore section 64(1)(iii) read with Explanation 2A was attracted and therefore the ITO was right in taxing the income of Rs. 1.12 lacs in the hands of the assessee. Being aggrieved the assessee has filed this appeal against the decision of the Tribunal u/s 260A of the Income Tax Act.

3. **ARGUMENTS;**

Mr Vashishth, learned counsel appearing on behalf of the assessee contended that the above two Trusts were created for the benefit of the minors(s). He argued that during the assessment year 1980-81, Ruchi and Nidhi were minors. That under the Trust Deeds income was to be accumulated till the minor attains the age of majority. That the Trusts were partners in the two firms respectively. That the Trust Funds amounting to Rs. 7,500/- in each case

was invested in the respective firms. He invited our attention to the various clauses of the said two Trust Deeds. He contended that in order to attract Explanation 2A to section 64(1)(iii) income should accrue to the minor(s) during the assessment year in question. That no income accrued to the minor(s) during the assessment year in question and therefore Explanation 2A to section 64(1)(iii) is not attracted. In this connection, it was submitted on behalf of the assessee that two conditions were required to be satisfied in order to attract Explanation 2A to section 64(1)(iii) namely, that the income should arise to the Trustee from the membership of the Trust in the firm and that such income should accrue for the benefit of the minor during the assessment year in question. Mr. Vashishth submitted that the second condition in this case is not satisfied. He argued that income has not accrued to the minors during the assessment year in question because under the Trust Deed the income had to be accumulated up to the age of 18 and therefore Explanation 2A was not attracted. He further contended that Explanation 2A was inserted by Finance Act No. (2) of 1979 only with effect from 1.4.1980 and therefore Explanation 2A was not applicable to the assessment year in question. He relied upon several judgments of the High Court in support of his contention.

Per contra, it was argued by Mr. P. Maulekhi, learned Counsel for the department that the right to receive income from the investments made by the Trustee in the firms had accrued to the minor(s) during the assessment year in question. He contended that under the Trust Deed in the event of the minor(s) getting married or in the event of the minor(s) meeting death prior to age of 18, the income was to devolve on the brothers and sisters of the minor(s) which indicated that income had accrued to the minor(s) during the assessment year in question and only payment was deferred till the minor(s) attained the age of 18 and therefore Explanation 2A to section 64(1)(iii) was applicable to the facts of

this case. He contended that the right to receive income vested in the minor(s) during the assessment year in question. That the share of the minor(s) under the Trust Deed was specific and not indeterminate and therefore the income of Rs.1.12 lacs was taxable in the hands of the assessee. He contended that the various judgments cited on behalf of the assessee did not apply to the facts of the present case because in the present case under the Trust Deed it has been stipulated that in the event of death of the minor(s) before reaching 18 years would result in devolution in favour of the younger brothers/younger un-married sisters surviving on the date of the death of the minors(s). That in the event of the marriage of the minor(s) before their death the interest of the deceased beneficiary in the corpus, income and assets of the Trust Fund developed on her brother which indicated that income had accrued to the minor(s) even before attaining the age of 18 and therefore the above income of Rs. 1.12 lacs was required to be taxed in the hands of their father, the assessee.

4. **QUESTIONS:**

The following questions have been referred to us in the above appeals:-

(a) "Whether, the Tribunal erred in holding that provisions of section 64(1)(iii) read with Explanation 2A were attracted particularly when the minor children of the assessee were not entitled to any right to the Trust Funds including the income from the Trusts until they attained the age of majority?"

(b) "Whether, in view of the decision of the Supreme Court in 211-ITR page 1, the Tribunal erred in coming to the conclusion that section 64(1)(iii) read with Explanation 2A was attracted in the facts of the present case?"

(c) "Whether, the Tribunal erred in not holding that the re-assessment proceedings were without jurisdiction and that no income had escaped assessment so as to attract section 147/148 of the Income Tax Act?"

OUR ANSWER:

For reasons given hereinafter all the above mentioned three questions are answered in the negative i.e. in favour of the department and against the assessee.

FINDINGS:-

Under Section 64(1)(iii), income arising to a minor from admission to the benefits of partnership, is included in the total income of that parent who has higher income, although neither of the parents is a partner in the firm to the benefits of which the minor is admitted. To counter the device, Finance Act 1979 inserted Explanation 2A to provide that where a minor is a beneficiary under a trust and trust is a partner in the firm, the income arising to the trust shall be deemed to arise indirectly to the minor and to that extent such income will be included in the total income of that parent who has the higher income. In this case, Rs. 7,500/- was settled in favour of each trust. The trust become the partner in the respective firms. In view of Explanation 2A the income of Rs. 1.12 lacs which accrued to the trust was the income which indirectly arose to the minor(s) by reason of the deeming fiction and therefore it was includible in the total income of the assessee. Further, under clause 3(b) of the Trust Deed it is inter alia provided that if the minor dies before 18 the interest in the Trust Fund was to devolve on the younger brother/sisters of the deceased but payment was to be made to the substituted beneficiary on attaining 18. This clause 3(b) indicates that a vested interest in the Trust Fund was given to the minor but payment was deferred till age of 18 so that accrued income could be utilized by the firm for a long periods. In fact, Explanation 2A was introduced in order not to allow the firms to use the income accruing for long periods. Therefore, judgment of Supreme Court in 211-ITR page 1 has no application to this case.

Lastly, the Finance Act No. (2) of 1979 came into force with effect from 1.4.1980 and therefore it was applicable to assessment year in question.

5. Accordingly, both the above appeals are disposed of. No cost.

(M.M. Ghildiyal, J.) **(S.H. Kapadia, C.J.)**

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